

Aqua America

WTR | \$42.06

In Line | TARGET PRICE: \$37.00

Commentary

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Company Statistics

Market Capitalization (M)	\$9,074
Shares Outstanding (M)	216
Dividend	0.91
Dividend Yield	2.2%
Payout Ratio	61.2%
Expected Total Return	(9.9)%
Fiscal Year End	Dec

Earnings Summary

	2019E	2020E	2021E
EPS	\$1.48	\$1.56	\$1.64
P/E	28.4	26.9	25.7
EPS vs Consensus	6.9%	(0.6)%	(1.9)%
Consensus EPS	\$1.38	\$1.57	\$1.67
Consensus P/E	30.4	26.7	25.2

1 Year Price History



Source: FactSet

In Line Quarter; Eyes On The Prize

WTR reported a largely in line 2Q19. FOUR key items worth highlighting are: 1) The Peoples Gas acquisition is still expected to close in fall of this year; 2) Potential acquisition of a PA-based wastewater operator DELCORA (~\$300mm rate base and ~\$0.03 EPS uplift by our estimate); 3) Repair tax pass-through may be pursued next year; and 4) Long-term guidance is expected to be issued in December. We use a sum-of-the-parts approach to value WTR using a blend of water and gas multiples. At this current juncture, we think the stock trades above our bull-base valuation and we see limited near-term upside; **our rating remains In Line.**

Earnings notes. 2Q19 adjusted EPS of \$0.37 was flat to prior year. EPS growth from rate cases and customer growth (acquisitions/organic) was offset by higher depreciation, lower consumption, and impact of repairs tax. 2019 capex is still expected to be ~\$550mm and the company reaffirmed its \$1.4bn capex plan through '21, which supports 7% rate base growth in their legacy water business. The Y/Y customer growth rate is still expected to be between 2-3% for '19 (from both organic growth and acquisitions).

Peoples Gas update. Aqua still targets to close the Peoples Gas acquisition in fall of this year. A settlement agreement has been filed with the administrative law judge with a recommended decision expected later this month, and a final PA commission order is expected in the fall. On the rate case front, a settlement agreement seeking \$59.5mm in rate increase is awaiting commission approval. New rates are expected to go into effect in October 2019.

Repairs tax election at Peoples could be up to \$0.10 EPS accretive (\$2/sh or 5% valuation uplift). In 2012, Aqua changed its tax method of accounting for qualifying utility asset repairs in PA. The tax accounting method was changed to permit the expensing of certain utility asset repairs/maintenance costs that were previously being capitalized and depreciated for tax purposes. The company used flow-through accounting for the tax benefits of the repair tax accounting change per the Pennsylvania rate order from June 2012. The flow-through accounting implementation resulted in a reduction in the company's effective income tax rate, which in turn lowered income tax expense and increased net income. WTR's effective tax rate was materially lower than the statutory tax rate at (7.7%) / 6.6% / 8.2% for the years '18 / '17 / '16 respectively. Higher earnings power supported higher returns on equity, which allowed Aqua to invest over \$2bn of capital on system improvements over the past seven years without having to go in for rate cases in PA. If regulators approve a similar tax treatment at Peoples, it could be up to \$0.10 accretive to EPS and \$2/sh accretive to value by our math. We will look for additional color at the Analyst Day in December this year.

DELCORA opportunity. On the call management announced that the Delaware County Regional Water Authority (DELCORA) had signed a letter of intent with the company committing to exclusive discussions, which could result in a potential combination. DELCORA is a wastewater conveyance and treatment authority that serves approximately 500,000 people in 42 municipalities in Delaware and Chester Counties in southeastern Pennsylvania. We estimate that this could be a potential ~\$300mm rate base (\$0.03 EPS) uplift, assuming 50%/50% debt/equity financing if they were to move forward.

We are maintaining our \$37 price target for WTR; our rating remains In Line. Our \$37 target price is based on a sum-of-the-parts valuation where we assign 23.0x '21 P/E to the earnings contribution from the legacy water business and ~21.0x to earnings from the gas segment. The 23.0x water P/E is in line with our water regulated peer average target multiple. The gas multiple of ~21x is also in line with current gas LDC trading valuation multiples. Our bull case valuation of \$39 assumes that both the water and gas segment trade at 5% premium to our base case scenario. Our bear case valuation of \$33 assumes a 10% discount multiple to our base case scenario for both segments. Please see Exhibit 1 for additional details.

Exhibit 1

WTR Post-Merger Valuation Framework

SOTP Valuation (Base Case)	'21E	'21 P/E	Valuation
Legacy WTR EPS	\$1.16	23.0x	\$27.00
Gas EPS	\$0.48	21.5x	\$10.00
	<u>\$1.65</u>		<u>\$37.00</u>
SOTP Valuation (Bull Case)	'21E	'21 P/E	Valuation
Legacy WTR EPS	\$1.16	24.1x	\$28.00
Gas EPS	\$0.48	22.6x	\$11.00
	<u>\$1.65</u>		<u>\$39.00</u>
SOTP Valuation (Bear Case)	'21E	'21 P/E	Valuation
Legacy WTR EPS	\$1.16	20.7x	\$24.00
Gas EPS	\$0.48	19.4x	\$9.00
	<u>\$1.65</u>		<u>\$33.00</u>

Source: Evercore ISI Research

VALUATION METHODOLOGY

Our \$37 target price is based on a SOTP where we assign 23.0x P/E to the earnings contribution from the legacy water business and ~21.0x to earnings from the gas segment. The 23.0x water P/E is in line with our water regulated peer average target multiple. The gas multiple of ~21.0x is also in line with current gas LDC trading valuation multiples.

RISKS

Risks to our thesis include an unfavorable regulatory outcome leading to lower rate base growth and/or lower allowed or earned ROEs in ongoing and future rate cases. Other risks include exposure to unusual weather, impact of conservation awareness of customers and more efficient plumbing fixtures and appliances on water usage per customer, cyber security and water contamination.

COMPANIES UNDER COVERAGE BY AUTHOR

Symbol	Company	Rating	Price (2019-08-08)	Evercore ISI Target
AWK	American Water Works Company, Inc.	Outperform	\$118.45	\$108.00
AWR	American States Water Company	Underperform	\$80.41	\$54.00
CTWS	Connecticut Water Service, Inc.	In Line	\$69.73	\$67.00
CWT	California Water Service Group	In Line	\$52.40	\$44.00
DCP	DCP Midstream, LP	In Line	\$24.66	\$34.00
ET	Energy Transfer Partners, L.P.	Outperform	\$13.33	\$18.00
KMI	Kinder Morgan, Inc.	Outperform	\$19.97	\$23.00
MPLX	MPLX LP	Outperform	\$27.12	\$39.00
SJW	SJW Group	In Line	\$64.19	\$62.00
TRP	TC Energy Corp.	In Line	CAD63.62	CAD60.00
WMB	The Williams Companies Inc.	Outperform	\$23.62	\$31.00
WTR	Aqua America	In Line	\$42.06	\$37.00

TIMESTAMP

(Article 3(1)e and Article 7 of MAR)

Time of dissemination: August 08 2019 09:11

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Outperform- the total forecasted return is expected to be greater than the expected total return of the analyst's coverage universe

In Line- the total forecasted return is expected to be in line with the expected total return of the analyst's universe

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Prior to March 2, 2017, Evercore ISI's recommendations were based on a stock's total forecasted return over the next 12 months:

Buy- the total forecasted return is expected to be greater than 10%

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Sell- the total forecasted return is expected to be less than 0%

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Strong Buy- Return > 20%

Buy- Return 10% to 20%

Neutral - Return 0% to 10%

Cautious- Return -10% to 0%

Sell- Return < -10%

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Overweight- the stock is expected to outperform the average total return of the analyst's coverage universe over the next 12 months.

Equal-Weight- the stock is expected to perform in line with the average total return of the analyst's coverage universe over the next 12 months.

Underweight- the stock is expected to underperform the average total return of the analyst's coverage universe over the next 12 months.

Suspended- the company rating, target price and earnings estimates have been temporarily suspended.

For disclosure purposes, Evercore Group's prior "Overweight," "Equal-Weight" and "Underweight" ratings were viewed as "Buy," "Hold" and "Sell," respectively.

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Evercore ISI rating (as of 08/08/2019)

Coverage Universe			Investment Banking Services I Past 12 Months		
Ratings	Count	Pct.	Ratings	Count	Pct.
Buy	396	51	Buy	268	68
Hold	315	41	Hold	170	54
Sell	39	5	Sell	16	41
Coverage Suspended	18	2	Coverage Suspended	14	78
Rating Suspended	10	1	Rating Suspended	4	40

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Price Charts

Aqua America Rating History as of 08/08/2019



Ratings Key

B	Buy	OP	Outperform	L	Long	CS	Coverage Suspended
H	Hold	IL	In Line	NP	No Position	RS	Rating Suspended
S	Sell	UP	Underperform	S	Short		

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